

Detecting Internal Control Problems Based on COSO and Islamic Perspective: Case on SMEs

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Abstract

Objective – The presence of Small Medium Enterprises (SMEs) has been able to be livelihoods sources and absorb more labor, even though it has a relative smaller contribution of additional value compared to the Large-scale Enterprises. The number of economic actors of SMEs spread across area from urban to rural. However, SMEs have faced several serious problems. These problems are caused by the unique characteristics of SMEs itself. First, lack of managerial skills due to limited human resources and lack of monitoring which it is rarely conducted by the manager or the owner. Second, lack of information and technology to carry out operations. Both problems have great impacts in lack of internal controls. Third, SMEs also face problems in developing business scale, limited access to capital to the banks and financial institutions due to the lack of transparency. Therefore, this research aimed to detect to what extent of the problems arising in the application and assessment of internal controls performed by SMEs.

Method – The research employs descriptive qualitative research method through direct observation, interview and business documentation owned by the company. Research materials are 29 SMEs consisting of 19 trading SMEs and 10 service SMEs. All SMEs are located in Malang city. Detection of application and assessment of internal controls in this study is based on the COSO framework and the Islamic perspective.

Result – Internal control activities indicators apply the five principles of COSO framework which focused on three layers. First layer is self-assessment control area. Second layer is environment control area and the third layer is independent control area. While the Islamic perspective is focused on the internal control of business activities based on the Qur'an and Hadith. The results derive from application and assessment based on COSO framework and Islamic perspectives are complementary in improving the practice of internal control.

Conclusion – Internal control problems detected in this study are generally caused by lack of managerial skills due to limited human resources, and lack of monitoring which it rarely done by manager or the owner, lack of technology and information to carry out the operations and moreover the accounting information system has not been well established. The results are expected to assist management in designing and implementing effective internal control system and provide assurance of easy access to capital.

Key Words : Internal Control Problems, COSO framework, Islamic Perspective, SMEs

Abstrak

Tujuan – Keberadaan Usaha Kecil Menengah (UKM) selama ini mampu menjadi sumber nafkah masyarakat, dan menyerap banyak tenaga kerja, meskipun memiliki kontribusi nilai tambah yang relatif lebih kecil dari pada Usaha berskala Besar. Jumlah pelaku ekonomi UKM tersebar diseluruh pelosok wilayah perkotaan hingga pedesaan. Akan tetapi banyak permasalahan yang dihadapi UKM. Permasalahan tersebut disebabkan oleh karakteristik unik dari UKM yaitu, pertama, lemahnya kemampuan manajerial karena keterbatasan sumberdaya manusia, serta monitoring yang jarang dilakukan oleh pimpinan ataupun pemilik. Kedua, lemahnya penguasaan teknologi dan

informasi dalam melaksanakan kegiatan operasional. Kedua masalah tersebut berakibat pada lemahnya pengendalian internal. UKM juga menghadapi masalah dalam mengembangkan skala usahanya yaitu terbatasnya akses permodalan kepada pihak perbankan dan lembaga keuangan karena kurangnya transparancy. Oleh karena itu, penelitian ini bertujuan untuk mendeteksi sampai sejauh mana masalah yang timbul dalam aplikasi dan penilaian pengendalian internal yang dilakukan UKM.

Metode – Metode penelitian adalah descriptive kualitatif dengan cara observasi langsung, wawancara dan kelengkapan dokumentasi usaha yang dimiliki oleh perusahaan. Materi penelitian adalah 29 UKM yang terdiri dari 19 UKM bergerak dibidang perdagangan dan 10 UKM bergerak dibidang jasa. Semua UKM berlokasi di Kota Malang. Deteksi pelaksanaan dan penilaian internal control dalam penelitian ini berdasarkan kerangka kerja COSO dan perspektif Islam.

Hasil – Indikator aktivitas pengendalian internal yang menerapkan kelima prinsip kerangka kerja COSO difokuskan pada tiga lapis. Lapis pertama yaitu area area pengendalian mandiri. Lapis kedua adalah area pengendalian lingkungan dan lapis ketiga adalah area pengendalian independen. Sedangkan Perspektif Islam difokuskan pengendalian internal pada aktivitas bisnis berdasarkan Al Qur'an dan Hadist. Hasil berasal dari aplikasi dan penilaian berdasarkan pada kerangka COSO dan perspektif Islam yang saling melengkapi dalam meningkatkan praktek pengendalian internal.

Kesimpulan – Deteksi masalah pengendalian internal dalam penelitian ini umumnya disebabkan oleh kurangnya keterampilan manajerial karena sumber daya manusia yang terbatas, dan kurangnya pengawasan yang jarang dilakukan oleh manajer atau pemilik, kurangnya teknologi dan informasi untuk melaksanakan operasi dan apalagi sistem informasi akuntansi belum mapan. Hasil penelitian diharapkan dapat membantu manajemen dalam merancang dan menerapkan sistem pengendalian internal yang efektif dan dapat memberikan jaminan kemudahan akses terhadap permodalan.

Kata Kunci : Masalah Pengendalian Internal, COSO Framework, Perspektif Islam, UKM

1. Introduction

Global financial crisis in 2008 has a great impact in companies, primarily large companies, to cut the production and shrink the business size from large to medium, medium to small, and small to micro. Many emerging business also established in the scale of micro and small enterprises as the result of labor layoffs and poverty.

Small and Medium Enterprises (SMEs) have a major role in the economy for the people in East Java. The existence of SMEs has been able to be a source of community living and absorbing more labor, despite having relatively smaller value-added contribution compared to large-scale enterprises. The numbers of economic SMEs actors are spread from urban areas to the countryside. SME business field covers several sectors, namely: (1) agriculture, (2) mining and excavation, (3) processing industry, (4) electricity, gas and water supply, (5) construction, (6) trade, hotels and restaurants, (7) transportation

and communication, (8) finance, leasing, and services company, and (9) other field of services.

Data from the Indonesian Central Bureau of Statistics in 2006 highlighted the number of SMEs nationwide reached 48.8 million small business (99.77%) and 106.7 million medium enterprises (0.22%). Contribution of SMEs in the formation of the Gross Domestic Product (GDP) reached Rp 1257.65 Trillion or 37.67% for small business and Rp 521.09 Trillion or 15.61% for medium business. Furthermore, contribution of SMEs in employment can accommodate 80,933,384 people or 91.14% for small business and 4,483,109 people or 5.05% for medium business. SMEs export contribute Rp 30.30 Trillion or 3.89% for small enterprises and Rp 91.90 Trillion or 11.81% for medium enterprises. Compared to big business, the numbers of large enterprises reached 7,204 (0.01%), GDP Rp. 1559.45 trillion (46.72%), absorbed employment of 3,388,462 people (3.82%) and the contribution of exports reached USD 485,198 Trillion (80.30%).

When compared to the number related to the contribution of labor absorption, SMEs absorb 91.14%, while large enterprises is only 3.82%. Gross Domestic Product of SMEs reached 37.67%, large business 46.72%. Moreover, exporting SMEs reached 11.81% and large enterprises 80.30 %. It can be concluded that SMEs have a strategic role in employment, but when compared to the GDP, the amount is still below the large enterprises and also compared with the exports of SMEs reached only 11.81 while large enterprises are reaching 80.30% (Department of Cooperatives and Micro, Small and Medium Enterprises of East Java, 2009).

During implementation, SMEs face many problems. These problems are caused by the unique characteristics of SMEs. First, lack of managerial skills due to limited human resources and lack of monitoring which it is rarely done by the manager or the owner. Second, lack of technology and information to carry out operations. Third, SMEs also face problems in developing business scale, limited access to capital to the banks and

financial institutions due to the lack of transparency. Therefore, to meet these needs, SMEs require a relatively large cost in order to be managed independently. The availability of government and private agencies that provide services in these areas is also very limited and uneven across regions (Department of Cooperatives and Small and Medium Enterprises of East Java, 2009). According to Hardesty (2008), the problems arises in smaller companies are due to the unique characteristic in those companies such as management override of controls, fewer employees which lead to limited opportunity for segregating incompatible duties, lack of information technology controls, lack of competence financial accounting personnel in adjustments to account or significant changes in financial report and disclosures. All problems have great impact in lack of internal controls, since those SMEs are busy to stay afloat in a competitive business environment. These facts put internal control as non priority. Effective internal controls are designed to provide reasonable assurance regarding the achievement of objectives of the following categories: effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations (COSO, 1992). This is important since internal control is a process affected by an entity's board of directors, management and other personnel in the company.

Furthermore, COSO describes five interrelated components of internal controls which consist of 1) **Control Environment** is sets of tone of an organization, influencing the control consciousness of its people, for example integrity and ethical value, board of directors, management philosophy and operating styles, organizational structure, financial reporting competencies, authority and responsibility, and human resources; 2) **Risk Assessment** is the entity's identification and analysis of relevant risks to the achievement of its objectives, forming a basis how risks should be managed, for example financial reporting risks and fraud risks; 3) **Control Activities** is the policies and procedure that help ensure that management directives are carried out; 4) **Information and**

Communication is the identification, capture, and exchange of information in a form and timeframe that enables people to carry out their responsibilities. For business process, the communication often takes the form of process narratives, system flowcharts, written policies and procedures, etc; 5) **Monitoring** is a process that assesses the quality of internal control performance over time (COSO, 1992; Rittenberg, 2006; Romney and Steinbart, 2006; Vona, 2008; Kumaat, 2011; Dull, Gelinas and Wheeler, 2012)

The increasing number of SMEs in the business competition not supported by adequate internal controls will affect their survival. Adequate internal control is essential in going concern of business. This study aims to detect to what extent the problems arise in application and assessment of internal control conducted in SMEs. After detecting internal control problems in SMEs, it is expected to assist management in designing and implementing effective internal control system to achieve effectiveness and efficiency of operations, reliability of financial reporting, compliance with applicable laws and regulations, and at the end provide assurance to easy access to capital. Moreover, to my knowledge, there is no previous research in internal control which integrated COSO framework and Islamic perspective, such as Rittenberg (2006); Hardesty (2008); Jones (2008); Danescu, Prozan, and Danescu (2011).

2. Methodology

This study was conducted using a descriptive qualitative method to describe the application and the assessment of internal control applied by SMEs. All SMEs in this research is located in Malang and has met the criteria based on the Law of the Republic of Indonesia No. 20 of 2008 on Micro, Small and Medium Enterprises. All companies hold a license in the form of CV, firm, PT and Sole Proprietorship.

This research select SMEs that have a commitment to improve internal control system to provide information, ease of access to capital and to implement good corporate

governance. 31 SMEs were examined in detail of 20 SMEs are trade companies and 11 SMEs are services companies. During the process, 1 trading SME and 1 services SME eliminated because it did not meet the requirements. Total final research object is 29 SMEs, consists of 19 trading SMEs and 10 services SMEs.

Internal control activity data is obtained through direct observation, interviews and examination of business documentation owned by SMEs. Then, data is analyzed based on the COSO (Committee of Sponsoring Organization) framework and Islamic perspectives. The study was conducted in 3 months from 5 March to 9 June 2012.

Indicator of internal controls over operational activities of SMEs focused on three layers according to Kumaat (2011). **First layer**, self assessment control area is the bottom-line action for to all parties within the organization in accordance with structural responsibility and authority of each element. Main activity of self-control consists of (1) good administration and (2) effective control. **The second layer** is the area of environment controls that apply the five principles of COSO framework. **The third layer** is independent control area that is a diagnostic action conducted by parties who have special competence to conduct independent analysis or control. Whilst, **the Islamic perspective** is assessed based on the Qur'an and Hadith in relation to internal control practices.

3. Results and Discussions

Strong internal controls can be a combination of the classic version of the COSO approach. Classic version of internal control emphasis on good management from planning (plan), implementation (do), evaluation (check) and development (act). The combination according to Kumaat (2011) consists of three layers as follows.

1. **First Layer**, self assessment control area that is organic to all parties in accordance with the structural organization of responsibility and authority of each

element in organization. The essence of self-control is adequate administrative and control, as defined below:

Good Administration = Sufficiency of Data + Traceability + Simplicity

Effective Control = Dual Control + Pre and Post Transaction + Standard Wise

2. **Second layer** is environment control area. This control is based on systemic functional responsibility and authority of each organization. The control area may be cross department.
3. **Third Layer** is independent control area. It is a diagnostic action done by parties who have special competence to conduct independent analysis or control. Internal auditor is the most responsible party to ensure that all other functions have been running adequately, both in terms of structural and functional.

These three layers has become the foundation to analyze the application and assessment of internal control in SMEs, which will be discussed in the following sections.

3.1. First Layer- Self Assessment Area

The results conducted in 29 trade and services SMEs through observation, structured interviews and documentation, obtained a description of the business environment. Internal control problems will be discussed as follows. Most SMEs have organizational structure. However, they apply a simple yet complex organizational structure. Owners generally have double function as the director and either lead the command line or directly to the employees. As presented in table 1, 79% of SMEs surveyed have a written job description, but experienced difficulties in the separation of duty and authority. Double functions and authority are generally occurred since there is no separation of duty. For example, the functions conducted between accounting department with revenue department, sales, cash disbursement, purchasing, and warehouse. The main reason is due to limited number human resources. Moreover, the

owners or managements rarely conduct monitoring. The observation results also indicate that 44.5% of companies have written internal policies. The internal policy is related to credit sales term of payment and payroll policy.

Based on the observation, employees who work on the company mostly are still family. Therefore, there is a lack of monitoring process and the control over the activities tends to loosen since it relied on a high level of confidence of family relations. As a result, the transparency related to the financial reporting has become a sensitive topic during the company's operations. Physical security and supervision to the company's assets is still low. Only 15.5 % of the companies from 29 SMEs have security personnel. The rest does not have a special security officer in charge to guard the warehouse and assist incoming guests in the company area.

Table 1. Understanding of SMEs Business Environment

No	Indicator	Average % to Apply
1	organizational structure	61.5
2	Clear segregation of duties and authority	79
3	The possibility of preventing the collusion among the employees who still has a family relation	33.5
4	Surveillance and physical security	15.5
5	internal policies	44.5
6	Adequate documentation	44
7	Budgeting System	48.5

SMEs held basic documentation in the form of cash receipts and disbursements, bank books, book of sales, book of purchasing and simple financial statement. Figure on table 2 indicates only 40% of trading companied records debts and account receivables, while 30% service companies record it. Generally, the flow of inventory is rarely recorded. As a result, it is found that the distribution of supplies in warehouse does not match between physical condition with the inventory records. Companies generally have difficulties to make a list of fixed assets because there is no separation between private ownership with the company due to limited business scale. Lack of supervision will potentially endanger company assets.

During the observation, several obstacles are encountered. There are several SMEs who cannot distinguish the accounts receivables with debt or account payables. Some recorded account receivable as debt account or account payable. Thus, it is not surprising only average of 30% of SMEs have a standard chart of accounts.

Trading SMEs are routinely providing financial statements, both monthly and annual basis. 53% do in monthly basis and 42% do annual financial statements, yet generally in the form of a simple cash flow statement. 58% of the trading SMEs collected supporting evidences the financial statements neatly.

Table 2. Basic Documentation

No	Indicator	% of Implementation	
		Trading SMEs	Service SMEs
1	Standard Chart of Account	37	30
2	Accounting Manual	53	50
3	Book of Cash Receipts	53	60
4	Book of Cash Disbursements	58	60
5	Book of Bank	47	40
6	Book of Purchasing	63	30
7	Book of Sales	74	40
8	Ledger	37	30
9	Book of Account Receivables	37	30
10	Book of Account Payables	42	30
11	Book of Inventory or Inventory Card	47	10
12	List of Fixed Assets	37	20
13	List of Revenue	47	40
14	List of Cost	47	40
15	Financial Statement	42	60

Table 3 indicates the use of information system in SMEs. Based on information system usage, 32% of trading SMEs and 50% service companies use computers to process accounting transactions, the rest is still based on manual basis. Generally, SMEs do not use special accounting software, only use the spreadsheet program. 42% of trading SMEs put the computer in a location which is not easily accessed by unauthorized parties. Password is rarely used as a safety, so even placed in a separate place, data leakage may still occur. Another drawback is to use the same computer for a variety of activities, not only the processing of accounting transactions only. Policies to download data or procedures have not become a top priority, thus it is not limited to those who were

entitled to access the data. Moreover, virus scanning has not been conducted yet. As the results, there is possibility of data loss due to a large number of virus.

Table 3. Information System

No	Indicator	% of Application	
		Trading SMEs	Service SMEs
1	Companies already processing bookkeeping with computer	32	50
2	Accessibility: Location and access to the computer equipment are accessible only by authorized personnel	42	20
3	The existence of safety access to system access, for example a password	37	50
4	There are policies or procedures for data downloading, removal computers to other location, and maintenance	32	40
5	Virus scanning is done periodically	32	30

3.2. *Second Layer – Environment Control Area*

This control area is applied inter-departmental or cross department and implemented COSO framework (2011). The focus of the discussion is the separation of task, adequate authorization systems, physical security, independent checks and adequate documentation of the following cycles:

3.2.1. *Revenue Cycle*

The revenue cycle includes sales in cash and credit. 63% of trading SMEs surveyed have a policy of sales and accounts receivable. The policy covers credit terms, setting a price list or tariff including the change of price list or if there is a specific provision should be discounted by the approval authorities. Usually the owner has double function either as owner or director. 14 or 74% of the trading SMEs surveyed used documentation in recording sales transactions. The document is in the form of simple invoices and is not prenumbered. Only 32% of trading SMEs that use distribution documents when sending goods to consumers. The accounting department rarely checks the correspondence between distribution documents with the amount of goods shipped, prices and terms of credit.

Observation and interview results showed 89% of trading SMEs held the dual job between accounting, sales and storage. Recording of receivables also rare. SMEs use simple registration process on receivables, and there is no aging schedule yet. The cashier did not separate with the accounting section which is weaken the internal control.

3.2.2. *Expenditure Cycle*

The observation results showed there is no particular purchasing staff or department who handle purchasing. The SMEs did not have an adequate list of suppliers, they generally have one or two suppliers and the process of price adjustment is not updated regularly.

3.2.3. *Human Resources Cycle*

The result indicates 29 SMEs apply a simple payroll system. Paycheck document is used as the evidence of payroll transaction

3.2.4. *Fixed Assets*

Documentation to record the existence of fixed assets does not exist, because it cannot distinguish between the company's fixed assets owned by owner.

The problems which arises in this second control can be justified through type of controls according to Albrecht *et al.* (2009) as presented in the following table.

Table 4. Type of Controls

Type of Control	Control Activities
Preventive Controls	<ol style="list-style-type: none"> 1. Segregation of Duties 2. System of Authorization 3. Physical Safeguards
Detective Controls	<ol style="list-style-type: none"> 1. Independent Checks 2. Documents and Records

Source: Albrecht *et al.* (2009)

Albrecht et al., 2009 illustrated in table 4 that types of activity controls consist of (1) preventive action or prevention in the form of separation of duties, proper

authorization systems, and physical security, as well as (2) detection action, that is the type of adequate independent checking and documentation done by SMEs. The result indicated that internal control activities undertaken by SMEs is still inadequate, therefore the gap for potential fraud is likely opened.

3.2.3. Third Layer – Independent Control Area

Independent control area is a diagnostic performed by those who have special competence to conduct independent analysis or control, an internal auditor or external auditor. All of 29 SMEs surveyed have not been examined by neither internal nor external parties. These SMEs are not public enterprises, therefore reporting their activities to the public has not become the major consideration.

The detection of internal control problems in SMEs based on COSO perspectives has resulted that lack of internal control mostly caused by inadequate accounting information system, lack of monitoring from the owner or management and lack of competence human resources. As the result, the flow of information for decision making, the reliability, relevancy, transparency and timeliness, is inhibited. The main reason why SMEs did not conduct adequate internal control is still focusing on business survival.

3.3. Internal Controls in Islamic Perspectives

Muhammad Baqir Al Sadr (2008) revealed his book *Economy Islam-Iqtishaduna*. There are two aspects in production activity. The first is objective aspect, which consists of the facilities that have been used, processed natural resources and expended working in the production activities. Secondly is the subjective aspect, which consists of psychological motives, goals to be achieved through the activities of production and evaluation of production activities according to various conceptions of adhered justice.

Therefore, internal control when it is viewed from the aspect of the objective in the study of Islam is described as follows. **Objective aspect** of production activity is a

source of economics study, in specific, or in conjunction with other science in order to discover the laws that control the production facilities and natural resources, to turn human mastering the laws and use it to organize the production in terms of the objective aspect for better and more critical success. Furthermore, the internal control according to the subjective aspect is evaluating the process. Motive can be seen from the behavior of the activity. The end goal leads to the improvement of both quality and quantity (Muhammad Baqir Ash Sadr, 2008). Compared to conventional concepts of internal control objectives, Mardi (2011) explained the purpose of internal control which consist of 1) maintain the security of the company property, 2) check the accuracy and correctness of accounting information, 3) improve the operational efficiency of enterprises, and 4) help to establish management discretion. Basically Internal control viewed from both the perspective, conventional and Islam, is apparently have a common goal. Internal control in the Islamic perspective both in objective and motive aspects of business activities are based on the Qur'an and Hadith which will be discussed in the following sections.

3.3.1. Muhasabah

Muhasabah is derived from the word 'hasibah' which mean to 'hisab' or count. Muhasabah is identical with self-assessment or evaluate or self-introspection. Therefore, a Muslim in doing muhasabah, must have self assessment, whether he is doing good deeds or make a lot of mistakes in his daily life. A Muslim should be objective in performing assessment based on the Qur'an and Sunnah. The assessment is not based on self desires. Similar to muhasabah, the evaluating the internal control system in SMEs should be objective and using a strong base, as said by Umar bin Khattab:

"Hisab (evaluate) yourself before you judged, and (prepared) for the day you aradh akbar (yaumul hisab)". (Takaful Umum, 2013)

In Umar Bin Khattab expression, he stated that internal control refers to any act or work performed that must be evaluated first by the authorities, for example by management or the internal auditor. Thus, before evaluated by external independent auditors, it should be evaluated and repaired first from within the organization or company.

Another direction comes from the Qur'an Surat Al-Hujurat verse 6 that teaches the importance of supervision and inspection functions (control and audit) in all activities, in this case economic activity.

"O you who believe! If an unrighteous person comes to you with information, you should verify it or else you might inflict harm on a people in ignorance and then end up regretting what you have done." (QS. Al-Hujurat: 6)

Surah Al-Hujurat verse 6 explained that we are advised to examine and investigate in advance of what we are doing to avoid disaster for others. When we hold a position, we should be able to maintain and responsible. If we hold the position with 'amanah' or trust, not cheating, it will bring a lot of trust from the people to keep that position. However, it is not only the responsibility but we also have to be honest and knowledgeable.

Further, the hadith also explained that we are encouraged to be an honest person. One of the main nature characteristics of mankind is honesty, because honesty is a foundation of happiness. Honesty involves many aspects especially in all matters of life and interests of the people. It can be seen from the Hadith of Bukhari which says:

"Be you all to be honest, because honesty leads to the goodness, and goodness brings to heaven. A person who is always be honest and searching for honesty will be written by God as an honest man (Siddeeq). And avoid lying, because lying leads to evil, and evil brought to hell. People, who are always lying and looking for lies, will be written by God as a liar (kadzdzab)." (HR Bukhari)

It is described that the urgency of internal controls are relating to the protection of company' assets, protect the rights, and avoid conflicts as stated in Surat Al-Baqarah verse 282.

“O you who have believed, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice. Let no scribe refuse to write as Allah has taught him. So let him write and let the one who has the obligation dictate. And let him fear Allah, his Lord, and not leave anything out of it. But if the one who has the obligation is of limited understanding or weak or unable to dictate himself, then let his guardian dictate in justice. And bring to witness two witnesses from among your men. And if there are not two men [available], then a man and two women from those whom you accept as witnesses - so that if one of the women errs, then the other can remind her. And let not the witnesses refuse when they are called upon. And do not be [too] weary to write it, whether it is small or large, for its [specified] term. That is more just in the sight of Allah and stronger as evidence and more likely to prevent doubt between you, except when it is an immediate transaction which you conduct among yourselves. For [then] there is no blame upon you if you do not write it. And take witnesses when you conclude a contract. Let no scribe be harmed or any witness. For if you do so, indeed, it is [grave] disobedience in you. And fear Allah. And Allah teaches you. And Allah is Knowing of all things.” (QS. Al-Baqarah: 282).

Based on surah Al-Baqarah verse 282, recording is one way that can be used as a tool of internal control. Recording is considered as the most important ways as the proof of ownership. Islamic legal scholars found the necessity of recording the transaction for ‘muamalah’. Records or documentation is used to protect the assets, protect all the parties who conduct a transaction, avoiding conflicts, lawsuits and disputes, anticipating doubts that sometimes occur in a contract, false contracts and as the means of controls.

3.4. *Ethical Foundation in Implementing Internal Control*

As stated in subjective aspect there is a motive in conducting internal control (Muhammad Baqir Ash Sadr, 2008). Motive can be described as an action, working or doing something, should have a code of conduct that shows good role model as it has been taught by the Prophet Muhammad SAW.

“There has certainly been for you in the Messenger of Allah an excellent pattern for anyone whose hope is in Allah and the Last Day and [who] remembers Allah often.” (QS. Al-Ahzab: 21)

Prophet Muhammad has a very noble morals traits. Therefore, the traits of prophet such as Siddiq, Amanah, Fathonah and Tabligh can be the foundation in applying internal control or other activities.

3.4.1. *Shiddiq*

Shiddiq means true. The words of Prophet Muhammad are true; either of his actions are also true. It is different comparing with the current leaders who have different words and actions. It is impossible the Prophet's is a liar and etc.

“4. It is not but a revelation revealed 5. Taught to him by one intense in strength” (QS. An Najm: 4-5)

QS. An Najm verse 4 and 5 explained that we should have shiddiq characteristic since conducting internal control in business activity need truth both in word and action, for example in recording in a transaction. With the truth, all evidences in the transaction will be clear and legitimate.

3.4.2. *Amanah*

Amanah means absolutely trustworthy. If someone is submitted a matter or an affair to him, people will believe that the affair will be done as well as possible. That is why Prophet Muhammad was nicknamed by residents of Mecca as "Al-Amin" which

means “reliable” long before he was promoted as Prophet. Whatever he said, residents of Mecca believed because he was not a liar.

“I convey to you the messages of my Lord, and I am to you a trustworthy adviser.” (QS. Al-A’raf: 68)

Surah Al-A’raf verse 68 explained that we should be able to be trusted if assigned in an affair. A good control would likely to be occurred if all the affairs are in the hands of trusted people. To sum up, the company has a good value when all dealings can be done by people who can be trusted since it greatly affects the work.

3.4.3. Fathonah

Fathonah means intelligent. It is impossible Prophet was stupid or jahlun. Conveying 6236 of the Qur'an verses and then explanation in the tens of thousands of hadith requires extraordinary intelligence. The prophet must be able to explain the words of God to his people so that they will embrace Islam. The Prophet must also be able to argue with unbelievers in the best possible way. Moreover, the Prophet was able to set his people from uncivilized Arabic people who divided and involved in inter-tribal war into a civilized and knowledgeable nation within 100 years. All of those require an extraordinary intelligence.

Having intelligence is an extraordinary gift to solve business problems and make good decisions without discriminate other party. Likewise, in internal control, an employee who has the intelligence will very helpful in explaining everything that is related to the company.

3.4.4. Tabligh

Tabligh means to convey. The Prophet delivered any word of Allah addressed to humans. Nothing is hidden even though may offended Prophet

*“That he may know that they have conveyed the messages of their Lord; and He has encompassed whatever is with them and has enumerated all things in number.
(QS. Al-Jinn: 28)*

The verse above explained that information must be delivered properly and suitable with reality. Information and communication can be used as the means of internal control because if the delivery was not right then it will destroy company related with decision making.

Based on previous discussion, the businessman should follow the example of four characteristics of the prophet when doing activities, especially internal control activities. At the end, it will generate relevant, reliable, timeliness information, guiding in expressing opinions, responsible and transparency reports without any cover-up.

4. Conclusion

Internal control problems detected in this study are generally caused by lack of managerial skills due to limited human resources, and lack of monitoring which it rarely done by manager or the owner, lack of technology and information to carry out the operations and moreover the accounting information system has not been well established. The results derive from application and assessment based on COSO framework and Islamic perspectives are complementary in improving the practice of internal control. The results are expected to assist management in designing and implementing effective internal control system and provide assurance of easy access to capital.

Future research and publications which related to the improvement of the internal control system can be done not only in trading and service SMEs, but also manufacturing SMEs. Since the research on SMEs is very broad and diverse, the development of research can be established by having an insight into the level of capitalization of SMEs. Finally, there is a wide opportunity to develop future research in accordance to the

integration between conventional conceptual and practices and Islamic perspective which still rare.

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